Richard Bernstein Advisors

The Leaders In Pactive® Management

RBA Quick Insights

February 1st, 2021

Wait…there's a baby in the bathwater!

Bubble, bubble toil and trouble

A good pint of beer always comes with a small layer of froth on top. So too with investments, it is normal for rising markets to have a bit of froth. But just as one would probably balk at receiving an ill-poured pint with half foam, some investors are beginning to balk at the idea of investing in stocks when over 40% of the market trades at more than 30x this year's expected earnings. From taxi drivers pitching stock ideas to surging SPAC offerings and social media driven stock frenzies, signs of bubble-like irrational behavior abound. The S&P 500® is back near its most expensive valuations since the Tech Bubble across a wide array of valuation metrics.

Faster growth at a cheaper price

But US investors need to be careful not to be too myopic. When you take a broad view of the financial markets, sentiment is quite skewed toward certain sectors and themes, and other ignored areas of the global equity markets present significant opportunities. Much of the elevated levels of sentiment and crowding appear concentrated in those US stocks generally associated with secular growth and disruption. To the credit of the fast-growing Tech companies, they performed amazingly well during the pandemic, but conversely, as the economy normalizes, they simply have no crisis from which to recover. Not only do small caps, international stocks, emerging markets, value and deep cyclicals offer much more reasonable valuations (Table 1), but they are also likely to offer superior profit growth as they recover from last year's pandemic-stricken earnings.

A bird in the hand is worth two in the bush…especially when interest rates are higher

If that wasn't enough, the recent reversal in interest rates should at least give growth investors some pause. Investors who pay high valuation multiples on today's profits are doing so on the hope that those profits will be much higher in the distant future. However, basic financial valuation principles imply that the further out in the future the profit stream, the less those profits are worth today when interest rates rise. Thus, these high-flying secular growth stocks are the equity market equivalent of a 30-year zero coupon bond (i.e. extremely interest rate sensitive). If interest rates continue to trend higher, it should be difficult for the high growth stocks to maintain their lofty multiples, especially when investors have the option to buy sectors like Financials that benefit from rising rates.

Table 1: Price to earnings valuation multiples for select global and style market indices

Market	P/E on Pre-Pandemic (2019) EPS	P/E on Pandemic (2020) EPS	P/E on Consensus 2021 EPS
US Large Cap Growth	38.7	42.2	29.8
NASDAQ 100	39.7	39.8	28.2
S&P 500® Technology	36.3	36.0	26.2
United States	26.2	30.6	22.4
Australia	18.2	39.9	19.1
US Large Cap Value	18.0	24.7	17.5
Japan	17.7	30.7	17.4
China	19.5	23.8	17.1
EM Asia	22.0	26.0	17.0
Europe	20.4	50.2	16.8
Canada	16.2	23.5	16.0
Emerging Markets	19.1	25.7	15.6
EM Latin America	14.9	49.7	12.5
Brazil	15.5	54.3	11.5

Source: Richard Bernstein Advisors LLC, Bloomberg, MSCI, S&P

Dan Suzuki, CFA
Deputy Chief Investment Officer

Please feel free to contact your regional portfolio specialist with any questions:
Phone: 212 692 4088
Email: sales@rbadvisors.com

For more information About Dan Suzuki, please click here.

Dan Suzuki is registered with Foreside Fund Services, LLC which is not affiliated with Richard Bernstein Advisors LLC or its affiliates.